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Dear Clients and Friends:

FEDERAL AND CALIFORNIA TAX MATTERS UPDATE

Significant tax legislation has been passed so far this year, and it is likely that even more changes are upcoming. We want to make sure you are aware of your opportunities and obligations with respect to some of these activities and what might be on the horizon for 2011.

PATIENT PROTECTION AND AFFORDABLE CARE ACT (HEALTH CARE ACT)

As you know, President Obama's health care reform legislation was passed. The full legislation has provisions that become effective in different years through 2018. Included in the bill are several federal tax provisions that become effective in 2010. These federal tax provisions include a small employer health insurance tax credit and expanded dependent coverage benefits.

Effective 2010 small employers (25 or less full-time equivalent employees under certain wage requirements) may qualify for a new tax credit if they provide a qualified health insurance plan. The maximum credit currently taken could be up to 35% of the amounts paid by the employer during the tax year. Also effective in 2010 the reform legislation allows self-employed individuals to take as a deduction insurance coverage for children under the age of 27 and an employee can receive health insurance benefits for their unmarried dependent children under the age of 27 from their employer on a tax free basis.

HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT (HIRE ACT)

The HIRE act created two key federal tax provisions to help out businesses. The first thing it did was extend the 2009 Section 179 first-year depreciation write-off deduction allowance of up to $250,000 into 2010. Before this was passed, the 2010 amount was reduced from the 2009 allowance of $250,000 to $134,000. The same phase-out threshold of $800,000 for 2009 also applies to 2010. Also a note that in 2011, barring any further law changes, the allowance amount will be back down to $25,000.

The second major provision of the HIRE act was to include incentives for employers to hire and retain qualified new employees. First, a Social Security tax exemption is now allowed for qualified new employees between March 19, 2010 and December 31, 2010. The 6.2% employer's portion of the Social Security tax doesn't have to be paid. Second, a new temporary tax credit can be claimed up to $1,000 for wages paid to each qualified new employee. The same time frame listed above applies to this as well. Among other requirements for the new temporary tax credit, the employee must work for 52 consecutive weeks, therefore for calendar year-end taxpayers, they likely cannot take advantage of the benefit of this credit until filing their 2011 federal income tax return in 2012.

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HIGHER FEDERAL TAXES IN 2011?

There has been a lot of recent publicity about paying higher taxes in 2011 compared to 2010. This is because absent legislative action, automatic "Sunset" provisions from the 2001 Bush tax cuts will reset a host of important federal tax provisions to their 2000 levels. So, if the government does not make any changes, you may be paying more federal taxes for 2011 than 2010, on the same amount of income. The first reason would be the reversion to the old tax rate bracket percentages with the top two tax brackets increasing from 33% to 36% and 35% to 39.6%. Secondly, the long term capital gains tax rate would generally increase to 20% from 15%. The last significant increase would cause dividends to be taxed at ordinary income tax rates, which could be as high as 39.6% from the current rate of 15% applicable for most dividends. A variety of other changes could increase your taxes including changes to limits for itemized deductions, exemptions, and alternative minimum tax. We are monitoring these likely tax law changes, and this will be an area that may require year-end tax planning in the upcoming months.

CALIFORNIA ELECTRONIC PAYMENT REQUIREMENTS

California passed the mandatory e-pay (electronic payment) requirement in late 2008 and the law became effective January 1, 2009. Under the law, individual taxpayers who have an estimated tax or extension payment liability over $20,000 or file an original return with a tax liability greater than $80,000 are required to e-pay. However, since the initial passing of the legislation the Franchise Tax Board ("FTB") has been lenient with taxpayers to comply with the e-pay requirement.

For 2009 and 2010 the FTB did not or will not assess penalties on taxpayers who are required to e-pay and are not doing so. However, penalties will be assessed beginning in 2011. So we will be working with you, as needed, to institute this new approach to paying California taxes.

STATUS OF FEDERAL ESTATE TAX

Another highly publicized tax issue is the federal estate tax. As it currently stands there is no federal estate tax for 2010. There are complexities regarding the basis of assets inherited this year and uncertainty for planning. Many assumed that there would have been legislation by now to undo this year's lack of estate tax brought on from the 2001 Bush tax cuts. Some feel that new legislation will be made in this area and that the new law may be retroactive to the beginning of the year. If retroactivity happens, it is possible that an estate of a wealthy person that died this year may contest its legality.

We hope that the information provided in this update is helpful for you. Tax laws are complicated and have many different requirements, so please be sure to consult with us before making any decisions on information generally mentioned in this letter. If you have any questions regarding these tax matters, please contact us.

Sincerely,

Sobul, Primes & Schenkel